have been no incentive under rate-of-return regulation to prescribe longer depreciation lives, because prescribing shorter lives would have reduced revenue requirements (a result not observed in the past). SWBT can and will provide its revenue requirement calculations to the Commission that demonstrate that apart from the elimination of specific rate element used to recover the reserve catch-up (and the associated price reduction) other access prices should not be prescriptively reduced when the depreciation catch-up amortization expires.

Reductions in the Depreciation Catch-up Amounts Because of Under-Utilized Plant are Not Appropriate.

The NPRM seeks comment on the effect, if any, that "under-utilization of equipment because of a transition to newer equipment, or because of reduced demand, should have on the calculation of any under-depreciation."[21] The existence of any so-called "under-utilization" of plant today was not caused by imprudent deployment of plant in the past. SWBT has historically performed engineering studies that demonstrate that its capital deployment decisions were proper at the time they were made, given: the need to meet the specific customer demand at that time; future "readiness to serve" obligations established by state and federal regulators; and the technologies available when the investments were made.

Also, SWBT's investment decisions have been subjected to intensive regulatory scrutiny, including rate cases, depreciation represcriptions, audits and other rigorous investigations. SWBT's decisions have already withstood this intense scrutiny. SWBT should not now be penalized by requiring unsubstantiated reductions to its depreciation catch-up amounts based on any unfounded claims regarding imprudency.

Justification of Economic Lives in SWBT's Depreciation Catch-up Calculations

The NPRM at paragraph 269 requests that LECs show the extent of under-depreciation and provide analysis that supports their calculations. SWBT has utilized a variety of analyses and data to determine the economic lives and net salvage which underlie its theoretical reserve catch-up. These analyses and data include:

A. Lives for Technology Accounts - For the technology accounts (e.g., copper cable, switching equipment, and circuit equipment), SWBT has used the following analyses and studies to determine economic lives:

- Recommendations for Southwestern Bell Telephone Equipment Lives (TFI, 1993) - SWBT-specific forecasts of remaining lives and projection lives for copper cable, fiber cable, switching equipment, and circuit equipment; based on economic usefulness.

[21] NPRM, para. 254.

- Personal Communications (TFI, 1993) - Industry forecasts of the effect of wireless communications on the remaining lives of copper distribution facilities; based on economic usefulness.

- Transforming the Local Exchange Network (TFI, 1994) - Industry forecasts of the effect of technology substitution on the remaining lives of embedded network technologies (fiber cable for copper cable; digital switching for electromechanical switching and analog electronic switching; newer digital switching components for older digital switching components; ATM switching for current digital switching; SONET circuit equipment for non-SONET circuit equipment; and faster SONET circuit equipment for slower SONET circuit equipment); based on economic usefulness.

- Depreciation Lives for Telecommunications Equipment (TFI, 1995) - Update to Transforming the Local Exchange Network.

- Wireless and Cable Voice Services (TFI, 1995) - Industry forecasts of the effect of wireless and CATV on the remaining lives of copper distribution facilities; based on economic usefulness.

- SWBT's life cycle analyses for copper cable and circuit equipment - These analyses calculate remaining lives based on SWBT-specific forecasts of plant retirements out through the end of the technology.

- SWBT's life span analyses for digital switching equipment - These analyses use SWBT-specific survivor curve and average interim retirement rate (over the life span of current digital switching) to forecast a remaining life which reflects the turnover of the various components of digital switches.

- FCC's Second Report and Order, et. al. (FCC 95-502), in MM Docket No. 93-215 and CS Docket No. 94-28 - Established allowed ranges of useful [projection] lives for CATV companies.

- FCC's Memorandum Opinion and Order (FCC 95-32) - 1994 represcription of projection lives for AT&T under the new Price Cap Carrier Option for depreciation simplification.

The SWBT-specific analyses were reviewed and compared with the TFI industry studies to determine the most-reasonable company economic average remaining lives (ARLs) for these accounts, consistent with SWBT's own deployment plans, operations, and environment. These company economic ARLs were then used in state-specific generation arrangements (with SWBT's proposed curve shapes from its 1995 Depreciation Rate Study) to determine state-specific economic average service lives (ASLs) and projection lives. As a further reasonableness check, SWBT's economic projection lives were also benchmarked against those prescribed by the FCC for AT&T and the CATV companies. The SWBT ARLs and state-specific ASLs were then used in the theoretical reserve calculation.

B. Lives for Fiber Cable - SWBT utilized a 20-year company economic projection life for all fiber cable accounts, based on TFI recommendations and benchmarking against the fiber lives prescribed by the FCC for AT&T and the CATV companies. This company economic projection life was used in state-specific generation arrangements (with SWBT's proposed curve shapes from its 1995 Depreciation Rate Study) to determine state-specific economic ARLs for each fiber account. These state ARLs were investment-weighted to obtain company economic ARLs for each fiber account. These company economic ARLs were then used in state-specific generation arrangements (with SWBT's proposed curve shapes from its 1995 Depreciation Rate Study) to determine state-specific economic ASLs for each fiber account. The company ARLs and state-specific ASLs were then used in the theoretical reserve calculation.

C. Lives for Non-Technology Accounts - SWBT's economic lives for these accounts are the same as the proposed projection lives in its 1995 Depreciation Rate Study. SWBT based these proposed projection lives on: consideration of historical life indications (i.e., implied by plant retirements); SWBT's policies, plans and operations; the judgment of its subject matter experts; and the projection life ranges established by the FCC for the LECs in CC Docket No. 92-296. These projection lives were used in state-specific generation arrangements (with SWBT's proposed curve shapes from its 1995 Depreciation Rate Study) to determine state-specific economic ARLs. These ARLs were investment-weighted to obtain company economic ARLs. These company economic ARLs were then used in state-specific generation arrangements (with SWBT's proposed curve shapes from its 1995 Depreciation Rate Study) to determine state-specific economic ASLs. The company ARLs and state-specific ASLs were then used in the theoretical reserve calculation.

D. Net Salvage for All Accounts - SWBT's economic net salvage percents for all accounts are the same as the proposed net salvage percents in its 1995 Depreciation Rate Study. SWBT based these proposed net salvage percents on consideration of its historical net salvage (Table A and Table B data included in its depreciation study); SWBT's policies, plans and operations; the judgment of its subject matter experts; and the future net salvage ranges established by the FCC for the LECs in CC Docket No. 92-296. Whenever these proposed net salvage percents were state-specific, they were investment-weighted to obtain company economic net salvage percents. The company net salvage percents were then used in the theoretical reserve calculation.

SWBT's economic lives for technology accounts are generally not based on retirements, and are generally shorter than its lives currently prescribed by the FCC. As recognized by depreciation experts, the economic life of an asset is the amount of time over which the asset has economic value, with respect to its usefulness for providing or supporting the services demanded by customers, and its ability to generate future cash sufficient to recover the asset.

On the other hand, lives for SWBT assets prescribed by the regulators are based heavily upon the retirements of assets. Specifically, in the prescription of SWBT's regulated lives, the FCC's depreciation practices have placed considerable reliance on the past retirements of assets (i.e., historical actuarial data) and near-term forecasts of future retirements (generally three years out). Even where the FCC has begun to acknowledge that purely historical data are not a valid

indicator of the lives of assets, its continued reliance on retirements (whether past or future) as an indicator of life has resulted in prescribed lives that are still too long, vis-à-vis economic lives. This is simply because retirements, whether past or future, are a very poor indicator of the decline in economic value of the assets.

When the FCC began to regulate depreciation lives for the setting of service rates, the primary cause for the decline in value of assets was, in fact, wear-and-tear (i.e., physical deterioration of the assets). In this environment, the assets were retired as soon as they were worn out. Thus, retirements of the assets formed a reasonable basis for estimating the life expectancy of the assets. However, as wear-and-tear has given way to technological and economic obsolescence, retirements are no longer a valid indicator of economic lives of assets.[22]

Also, the FCC has been motivated over the years to prescribe overly-long depreciation lives, because doing so has kept incumbent LECs' regulated costs (i.e., revenue requirements) lower than they otherwise would have been, which, in turn, has kept the ILECs' tariffed prices lower than they otherwise would have been. This arrangement was not without benefit; it helped to promote a national goal of universal telephone service. However, implicit in this arrangement was the understanding that the incumbent LECs would eventually be able to complete the capital recovery of their assets in the future regulated costs of service, even after the assets no longer had economic value, and sometimes even after they had already been physically removed and retired.

In the major technology-driven accounts (such as central office switches and outside plant cables), lives determined by analyses of past and near-term future retirements are very long until the last few years of use of these technologies. Then, during those last few years of a technology, retirements finally begin to signal the actual end of the technology's use. This is simply because most of the retirements are concentrated in the last part of the technology's life span. The result, over time, is a long life prediction for many years, and a much shorter life prediction for the last few years. Therefore, the use of retirement data to estimate lives produces totally incorrect life predictions for most of the life of the technology.

Conversely, the actual economic value of the assets has been declining gradually, long before the last few years of use (i.e., long before the bulk of the retirements). Analyses which recognize the gradual loss of value over time properly predict the economic lives of the assets throughout all years of use. The annual loss in economic value of an asset will likely not be uniform or constant throughout the asset's entire useful life. Instead, the decline in value will track with the decline in actual use of the services generated by the asset. Indeed, this decline will begin to occur long before the asset is retired.

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[22]See footnote 13.

Even though the FCC's remaining life depreciation method or dying account amortization method would eventually respond[23] to the rapid retirements occurring toward the end of a technology's life span, this is no longer a reasonable approach to take in the new competitive environment. This is because the full recovery of the assets would not be possible on such a delayed basis. In other words, if the depreciation costs in SWBT's prices were retirements-based, then: (a) SWBT's current prices would be too low (relative to economic depreciation costs); and (b) SWBT's future prices would have to be significantly higher because of the large depreciation catch-up necessitated by the initial under-depreciation. This would place SWBT at a significant and unfair disadvantage in the future, when the competitive marketplace will not sustain the additional, large cost of the depreciation catch-up.

Retirements are not able to track the gradual loss in value for the major technology accounts for several reasons. First, consider switches. Retirements of entire switches do not occur smoothly throughout the overall life span of a switch technology (such as electromechanical switching), because of the events which trigger the final demise of that technology. Even though some retirements of entire switches or parts of switches do occur throughout the technology's life span (due to physical exhaust or component upgrades), most of the retirements tend to be concentrated in a relatively short period of time, toward the end of the technology's life span. This happens primarily because of: (a) the rapid ramping-up of customer demand for new services that the older switch technology cannot provide (e.g., custom calling services); (b) regulatory requirements that the older switch technology cannot handle (e.g., equal access and number portability); and (c) the inevitable loss of vendor support for the older switch technology as the end of its life span draws near. This pattern of concentrated retirements toward the end of the technology's life span has already been observed for both electromechanical switching and analog electronic switching.

Of course, the current switch technology is digital switching. Although SWBT's current experience with the "interim" retirements of individual components of digital switches does track somewhat better with the actual loss in economic value of these assets, two important points must be made. First, even when digital switching lives are based upon SWBT's present and future interim retirements, they are about six to seven years shorter than those currently prescribed by the FCC. The prescribed lives are longer because the FCC is using interim retirement data that is only historical, and not even SWBT-specific. Second, even SWBT's significant interim retirements do not signal the eventual total replacement of the current digital switching technology by more advanced types of digital switches, such as the asynchronous transfer mode (ATM) switches.

In the case of copper cables, retirements do not track with the loss in value over time because of the physical nature of these assets. The decline in usefulness (and hence, value) over time will be largely due to the migration of SWBT's customers from this technology to

[23] This eventual response (the increase the regulated depreciation expense) is but one half of the requirement for capital recovery. The other half is the cash revenues equal to the noncash expense necessary to return the original investment to shareholders (i.e., the investors who loaned the cash for the original capital investment in the first place).

higher-density, higher-bandwidth or wireless facilities owned by SWBT or its competitors. Because this migration occurs cable pair-by-cable pair, the economic value of copper cables declines gradually over time. However, because of the FCC's Part 32 accounting rules, the retirement of a particular cable cannot occur until the very last pair in that cable has been vacated. Therefore, most of the retirements in this asset category will tend to occur toward the end of the life span of this technology. Hence, the FCC's life prescriptions based upon historical retirements or near-term forecasts of retirements simply do not anticipate this concentration of retirements at the end of the technology's use, and therefore, end up being much longer than the useful (i.e., economic) lives of these assets.

Summary

As a result of changes in technology and competition in the telecommunications industry, the incumbent LECs are faced with a past under-depreciation problem. A conservative estimate of this problem can be made using economic lives to calculate a theoretical reserve deficiency (i.e., catch-up). This deficiency should be eliminated with a five-year amortization, accompanied by the use of the same economic lives in ongoing depreciation rates. This depreciation catch-up amortization should be recovered from the customers who have enjoyed the past benefits of the deferred capital recovery of past investments, not from shareholders, who bear all of the risk for future investments.

Submitted,

John Lube

John Lube
Director-Capital Recovery

January 29, 1997

COMPANY: SOUTHWESTERN BELL
STATE: COMPANY
ACCOUNT: STATEMENT C - RESERVES

ACCOUNT	CATEGORY	12-31-96 INVESTMENT	BOOK RESERVE AMOUNT	THEORETICAL RESERVE AMOUNT	CATCH-UP AMOUNT
		A	B	H	J=B-H
2112	MOTOR VEHICLES	278,296,000	151,692,000	137,361,081	14,330,919
2115	GARAGE WORK EQPT	7,644,000	5,225,000	8,509,102	-3,284,102
2116	OTHER WORK EQPT	190,065,000	88,312,000	71,405,148	16,906,852
2121	BUILDINGS	2,517,509,000	664,591,000	575,176,208	89,414,792
2122	FURNITURE	6,757,000	2,303,000	2,400,660	-97,660
2123.1	OFFICE SUPPORT EQPT	31,984,000	15,993,000	14,022,810	1,970,190
2123.2	COMPANY COMM EQPT	440,125,000	257,696,000	224,584,402	33,111,598
2124	GENL PURP COMPUTERS	654,112,000	337,012,000	308,268,182	28,743,818
2211	ANALOG ELECT SW	1,950,891,000	1,165,018,000	1,317,771,426	-152,753,426
2212	DIGITAL ELECT SW	3,440,718,000	1,004,217,000	1,401,230,232	-397,013,232
2220	OPERATOR SYSTEMS	154,429,000	84,555,000	55,029,940	29,525,060
2231	RADIO	159,853,000	93,382,000	94,079,904	-697,904
2232	CIRCUIT EQPT				
	DIGITAL DATA SYSTEMS	100,100,000	56,362,000	52,092,284	4,269,716
	DIGITAL CIRCUIT	4,563,838,000	2,028,973,000	2,406,947,202	-377,974,202
	ANALOG CIRCUIT	820,211,000	608,256,000	585,120,940	23,135,060
2311	STATION APPARATUS	7,627,000	4,852,000	3,723,535	1,128,465
2341	LARGE PBX	52,265,000	28,542,000	21,678,766	6,863,234
2351	PUBLIC TELEPHONE	219,503,000	148,563,000	143,683,331	4,879,669
2362	OTHER TERMINAL EQPT	226,576,000	134,779,000	112,554,283	22,224,717
2411	POLES	334,319,000	300,876,000	433,216,353	-132,340,353
2421	AERIAL CABLE	1,511,911,000	1,005,076,000	1,116,745,864	-111,669,864
2422	UNDERGROUND CABLE				
	EXCH METALLIC	1,798,165,000	1,028,972,000	1,321,100,712	-292,128,712
	TOLL METALLIC	19,418,000	17,119,000	15,693,639	1,425,361
	EXCH FIBER	427,392,000	96,434,000	121,690,506	-25,256,506
	TOLL FIBER	72,507,000	31,366,000	30,963,191	402,809
2423	BURIED CABLE				
	EXCH METALLIC	6,543,873,000	3,553,553,000	4,018,307,375	-464,754,375
	TOLL METALLIC	145,234,000	96,329,000	112,596,889	-16,267,889
	EXCH FIBER	262,270,000	43,381,000	48,249,568	-4,868,568
	TOLL FIBER	324,849,000	84,739,000	86,913,852	-2,174,852
2424	SUBMARINE CABLE	4,803,000	3,038,000	2,377,683	660,317
2426	INTRABLDG NTWK CABLE	142,424,000	97,368,000	80,483,545	16,884,455
2431	AERIAL WIRE	1,950,000	6,488,000	2,847,664	3,640,336
2441	CONDUIT SYSTEMS	1,465,882,000	382,813,000	460,490,650	-77,677,650
	TOTAL	28,877,500,000	13,627,875,000	15,387,316,927	-1,759,441,927

COMPANY: SOUTHWESTERN BELL
STATE: ARKANSAS
ACCOUNT: STATEMENT C - RESERVES

ACCOUNT	CATEGORY	12-31-96 INVESTMENT	BOOK RESERVE AMOUNT	THEORETICAL RESERVE AMOUNT	CATCH-UP AMOUNT
		A	B	H	J=B-H
2112	MOTOR VEHICLES	18,305,000	10,707,000	9,115,890	1,591,110
2115	GARAGE WORK EQPT	21,000	-4,000	19,551	-23,551
2116	OTHER WORK EQPT	12,274,000	5,479,000	4,222,256	1,256,744
2121	BUILDINGS	140,407,000	34,296,000	31,310,761	2,985,239
2122	FURNITURE	155,000	119,000	59,365	59,635
2123.1	OFFICE SUPPORT EQPT	1,050,000	408,000	411,600	-3,600
2123.2	COMPANY COMM EQPT	25,497,000	14,130,000	12,264,057	1,865,943
2124	GENL PURP COMPUTERS	14,100,000	9,520,000	7,374,300	2,145,700
2211	ANALOG ELECT SW	0	-762,000	0	-762,000
2212	DIGITAL ELECT SW	289,567,000	76,540,000	109,456,326	-32,916,326
2220	OPERATOR SYSTEMS	7,289,000	3,503,000	1,997,186	1,505,814
2231	RADIO	17,268,000	3,696,000	8,616,732	-4,920,732
2232	CIRCUIT EQPT				
	DIGITAL DATA SYSTEMS	3,635,000	1,964,000	1,603,035	360,965
	DIGITAL CIRCUIT	286,327,000	108,884,000	139,727,576	-30,843,576
	ANALOG CIRCUIT	69,830,000	48,299,000	47,903,380	395,620
2311	STATION APPARATUS	633,000	534,000	399,423	134,577
2341	LARGE PBX	5,351,000	3,180,000	2,215,314	964,686
2351	PUBLIC TELEPHONE	14,805,000	11,302,000	9,712,080	1,589,920
2362	OTHER TERMINAL EQPT	11,434,000	6,119,000	5,865,642	253,358
2411	POLES	23,479,000	19,075,000	32,682,768	-13,607,768
2421	AERIAL CABLE	74,049,000	62,206,000	59,017,053	3,188,947
2422	UNDERGROUND CABLE				
	EXCH METALLIC	81,928,000	51,696,000	60,954,432	-9,258,432
	TOLL METALLIC	1,361,000	1,519,000	1,125,547	393,453
	EXCH FIBER	11,624,000	1,999,000	3,138,480	-1,139,480
	TOLL FIBER	3,169,000	1,440,000	1,248,586	191,414
2423	BURIED CABLE				
	EXCH METALLIC	644,747,000	343,380,000	402,322,128	-58,942,128
	TOLL METALLIC	12,191,000	8,497,000	9,277,351	-780,351
	EXCH FIBER	29,379,000	2,886,000	3,642,996	-756,996
	TOLL FIBER	25,986,000	7,436,000	6,678,402	757,598
2424	SUBMARINE CABLE	671,000	326,000	277,123	48,877
2426	INTRABLDG NTWK CABLE	4,185,000	3,325,000	2,368,710	956,290
2431	AERIAL WIRE	3,000	447,000	3,384	443,616
2441	CONDUIT SYSTEMS	62,771,000	21,928,000	21,781,537	146,463
	TOTAL	1,893,491,000	864,074,000	996,792,971	-132,718,971

COMPANY: SOUTHWESTERN BELL
STATE: KANSAS
ACCOUNT: STATEMENT C - RESERVES

ACCOUNT	CATEGORY	12-31-96 INVESTMENT	BOOK RESERVE AMOUNT	THEORETICAL RESERVE AMOUNT	CATCH-UP AMOUNT
		A	B	E	J=B-E
2112	MOTOR VEHICLES	23,474,000	12,745,000	11,267,520	1,477,480
2115	GARAGE WORK EQPT	82,000	40,000	94,710	-54,710
2116	OTHER WORK EQPT	18,192,000	8,158,000	6,803,808	1,354,192
2121	BUILDINGS	174,981,000	49,343,000	41,995,440	7,347,560
2122	FURNITURE	1,023,000	164,000	282,348	-118,348
2123.1	OFFICE SUPPORT EQPT	1,423,000	536,000	591,968	-55,968
2123.2	COMPANY COMM EQPT	36,856,000	20,015,000	17,727,736	2,287,264
2124	GENL PURP COMPUTERS	14,313,000	8,769,000	7,485,699	1,283,301
2211	ANALOG ELECT SW	90,163,000	44,470,000	58,696,113	-14,226,113
2212	DIGITAL ELECT SW	321,609,000	95,355,000	130,573,254	-35,218,254
2220	OPERATOR SYSTEMS	4,821,000	1,154,000	993,126	160,874
2231	RADIO	21,456,000	7,503,000	12,101,184	-4,598,184
2232	CIRCUIT EQPT				
	DIGITAL DATA SYSTEMS	3,729,000	2,181,000	1,719,069	461,931
	DIGITAL CIRCUIT	407,757,000	181,256,000	219,781,023	-38,525,023
	ANALOG CIRCUIT	59,103,000	38,449,000	41,844,924	-3,395,924
2311	STATION APPARATUS	721,000	445,000	426,832	18,168
2341	LARGE PBX	2,738,000	1,585,000	1,347,096	237,904
2351	PUBLIC TELEPHONE	18,913,000	12,387,000	11,915,190	471,810
2362	OTHER TERMINAL EQPT	18,490,000	10,399,000	9,226,510	1,172,490
2411	POLES	21,525,000	24,369,000	24,990,525	-621,525
2421	AERIAL CABLE	81,203,000	48,385,000	59,359,393	-10,974,393
2422	UNDERGROUND CABLE				
	#REF!	108,899,000	67,483,000	77,427,189	-9,944,189
	TOLL METALLIC	1,208,000	774,000	960,360	-186,360
	#REF!	30,874,000	8,448,000	8,829,964	-381,964
	TOLL FIBER	8,687,000	3,152,000	3,466,113	-314,113
2423	BURIED CABLE				
	#REF!	576,891,000	310,267,000	349,019,055	-38,752,055
	TOLL METALLIC	18,193,000	10,904,000	13,917,645	-3,013,645
	#REF!	47,153,000	10,190,000	9,807,824	382,176
	TOLL FIBER	59,918,000	15,227,000	15,878,270	-651,270
2424	SUBMARINE CABLE	252,000	194,000	128,520	65,480
2426	INTRABLDG NTWK CABLE	4,757,000	2,962,000	2,564,023	397,977
2431	AERIAL WIRE	379,000	666,000	551,824	114,176
2441	CONDUIT SYSTEMS	68,597,000	20,529,000	24,694,920	-4,165,920
	TOTAL	2,248,380,000	1,018,504,000	1,166,469,175	-147,965,175

COMPANY: SOUTHWESTERN BELL
STATE: MISSOURI
ACCOUNT: STATEMENT C - RESERVES

ACCOUNT	CATEGORY	12-31-96 INVESTMENT	BOOK RESERVE AMOUNT	THEORETICAL RESERVE AMOUNT	CATCH-UP AMOUNT
		A	B	H	J=B-H
2112	MOTOR VEHICLES	43,578,000	22,479,000	22,094,046	384,954
2115	GARAGE WORK EQPT	244,000	49,000	216,672	-167,672
2116	OTHER WORK EQPT	32,675,000	15,213,000	10,782,750	4,430,250
2121	BUILDINGS	683,426,000	149,949,000	152,403,998	-2,454,998
2122	FURNITURE	1,670,000	-233,000	522,710	-755,710
2123.1	OFFICE SUPPORT EQPT	4,931,000	1,634,000	1,834,332	-200,332
2123.2	COMPANY COMM EQPT	109,175,000	54,502,000	59,063,675	-4,561,675
2124	GENL PURP COMPUTERS	283,084,000	129,891,000	124,556,960	5,334,040
2211	ANALOG ELECT SW	269,504,000	123,111,000	175,447,104	-52,336,104
2212	DIGITAL ELECT SW	571,255,000	167,790,000	225,645,725	-57,855,725
2220	OPERATOR SYSTEMS	24,167,000	10,615,000	9,207,627	1,407,373
2231	RADIO	42,128,000	23,106,000	24,897,648	-1,791,648
2232	CIRCUIT EQPT				
	DIGITAL DATA SYSTEMS	13,883,000	9,633,000	7,288,575	2,344,425
	DIGITAL CIRCUIT	722,464,000	319,642,000	362,676,928	-43,034,928
	ANALOG CIRCUIT	120,584,000	79,623,000	85,735,224	-6,112,224
2311	STATION APPARATUS	2,149,000	1,503,000	1,207,738	295,262
2341	LARGE PBX	9,325,000	4,313,000	3,599,450	713,550
2351	PUBLIC TELEPHONE	38,594,000	22,148,000	25,201,882	-3,053,882
2362	OTHER TERMINAL EQPT	35,543,000	19,625,000	18,233,559	1,391,441
2411	POLES	65,798,000	53,538,000	88,893,098	-35,355,098
2421	AERIAL CABLE	194,524,000	116,014,000	155,035,628	-39,021,628
2422	UNDERGROUND CABLE				
	EXCH METALLIC	224,757,000	137,422,000	168,792,507	-31,370,507
	TOLL METALLIC	1,795,000	1,366,000	1,468,310	-102,310
	EXCH FIBER	83,154,000	20,323,000	22,451,580	-2,128,580
	TOLL FIBER	15,641,000	6,447,000	6,444,092	2,908
2423	BURIED CABLE				
	EXCH METALLIC	1,057,484,000	472,262,000	626,030,528	-153,768,528
	TOLL METALLIC	16,214,000	8,739,000	11,901,076	-3,162,076
	EXCH FIBER	28,986,000	4,640,000	5,739,228	-1,099,228
	TOLL FIBER	58,700,000	14,695,000	13,735,800	959,200
2424	SUBMARINE CABLE	444,000	251,000	195,360	55,640
2426	INTERABLDG NTWK CABLE	21,981,000	10,742,000	12,441,246	-1,699,246
2431	AERIAL WIRE	484,000	2,495,000	719,224	1,775,776
2441	CONDUIT SYSTEMS	179,883,000	48,730,000	62,419,401	-13,689,401
	TOTAL	4,958,224,000	2,052,257,000	2,486,883,681	-434,626,681

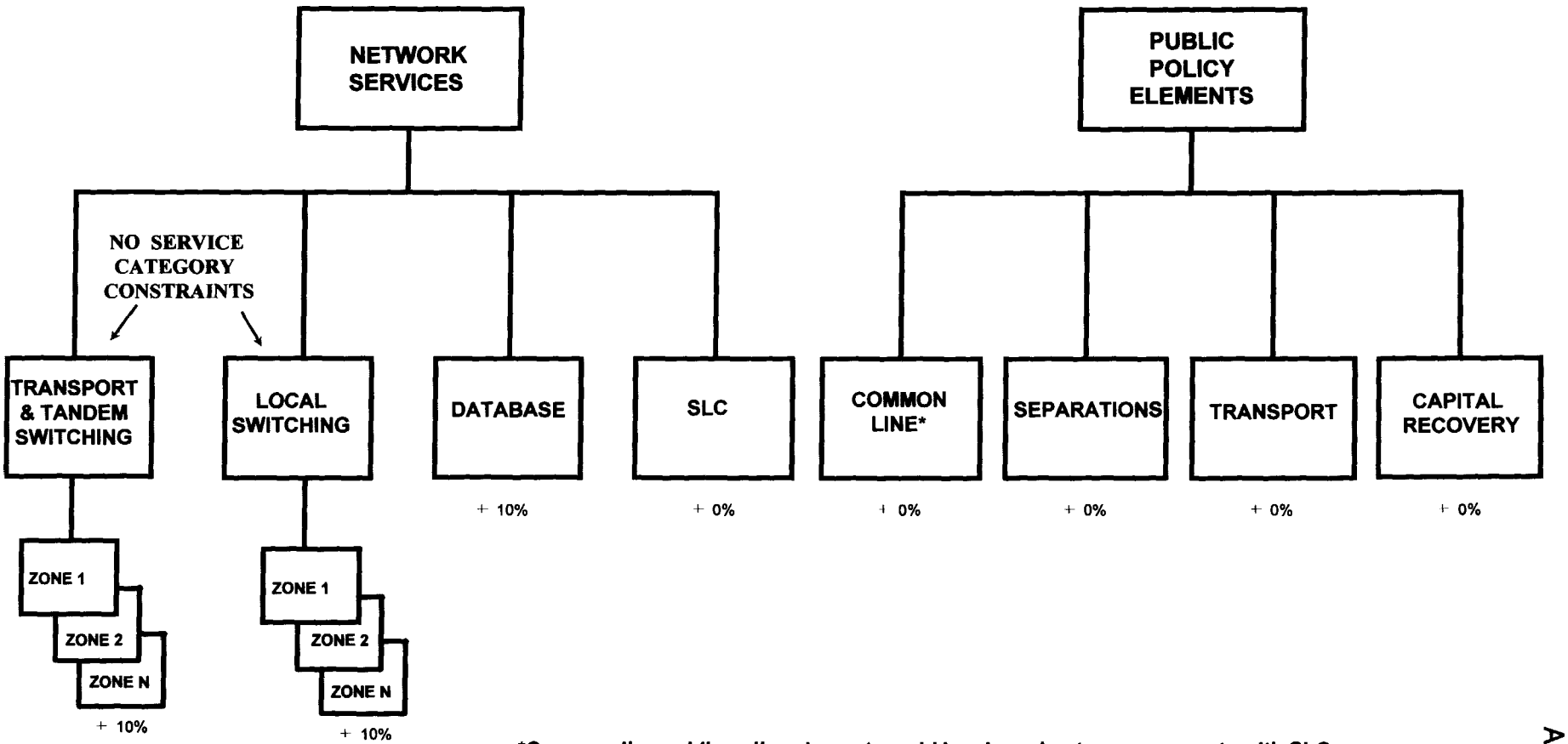
COMPANY: SOUTHWESTERN BELL
STATE: OKLAHOMA
ACCOUNT: STATEMENT C - RESERVES

ACCOUNT	CATEGORY	12-31-96 INVESTMENT	BOOK RESERVE AMOUNT	THEORETICAL RESERVE AMOUNT	CATCH-UP AMOUNT
		A	B	H	J=B-H
2112	MOTOR VEHICLES	29,803,000	17,230,000	15,110,121	2,119,879
2115	GARAGE WORK EQPT	59,000	8,000	42,657	-34,657
2116	OTHER WORK EQPT	18,574,000	8,642,000	6,798,084	1,843,916
2121	BUILDINGS	224,938,000	86,779,000	60,958,198	25,820,802
2122	FURNITURE	663,000	-115,000	260,559	-375,559
2123.1	OFFICE SUPPORT EQPT	2,559,000	1,061,000	1,187,376	-126,376
2123.2	COMPANY COMM EQPT	41,819,000	27,549,000	21,913,156	5,635,844
2124	GENL PURP COMPUTERS	23,987,000	18,745,000	13,360,759	5,384,241
2211	ANALOG ELECT SW	111,583,000	54,526,000	70,074,124	-15,548,124
2212	DIGITAL ELECT SW	384,422,000	109,282,000	154,153,222	-44,871,222
2220	OPERATOR SYSTEMS	12,077,000	7,271,000	3,478,176	3,792,824
2231	RADIO	37,663,000	32,771,000	24,405,624	8,365,376
2232	CIRCUIT EQPT				
	DIGITAL DATA SYSTEMS	8,378,000	5,233,000	4,482,230	750,770
	DIGITAL CIRCUIT	375,085,000	157,874,000	190,543,180	-32,669,180
	ANALOG CIRCUIT	98,268,000	77,913,000	72,325,248	5,587,752
2311	STATION APPARATUS	1,265,000	786,000	737,495	48,505
2341	LARGE PBX	6,328,000	3,349,000	2,708,384	640,616
2351	PUBLIC TELEPHONE	24,115,000	16,450,000	15,747,095	702,905
2362	OTHER TERMINAL EQPT	29,112,000	18,140,000	15,342,024	2,797,976
2411	POLES	28,290,000	36,476,000	41,444,850	-4,968,850
2421	AERIAL CABLE	94,237,000	78,458,000	74,447,230	4,010,770
2422	UNDERGROUND CABLE				
	#REF!	156,441,000	97,392,000	116,392,104	-19,000,104
	TOLL METALLIC	3,360,000	2,933,000	2,866,080	66,920
	#REF!	28,613,000	7,998,000	9,156,160	-1,158,160
	TOLL FIBER	8,965,000	4,037,000	3,944,600	92,400
2423	BURIED CABLE				
	#REF!	886,591,000	517,609,000	553,232,784	-35,623,784
	TOLL METALLIC	24,439,000	19,076,000	19,404,566	-328,566
	#REF!	33,156,000	5,845,000	5,205,492	639,508
	TOLL FIBER	49,990,000	13,444,000	12,847,430	596,570
2424	SUBMARINE CABLE	1,216,000	930,000	644,480	285,520
2426	INTRABLDG NTWK CABLE	14,742,000	12,518,000	8,343,972	4,174,028
2431	AERIAL WIRE	860,000	577,000	1,255,600	-678,600
2441	CONDUIT SYSTEMS	96,541,000	26,930,000	32,051,612	-5,121,612
	TOTAL	2,858,139,000	1,467,717,000	1,554,864,672	-87,147,672

COMPANY: SOUTHWESTERN BELL
STATE: TEXAS
ACCOUNT: STATEMENT C - RESERVES

ACCOUNT	CATEGORY	12-31-96 INVESTMENT	BOOK RESERVE AMOUNT	THEORETICAL RESERVE AMOUNT	CATCH-UP AMOUNT
		A	B	H	J=B-H
2112	MOTOR VEHICLES	163,136,000	88,531,000	79,773,504	8,757,496
2115	GARAGE WORK EQPT	7,238,000	5,132,000	8,135,512	-3,003,512
2116	OTHER WORK EQPT	108,350,000	50,820,000	42,798,250	8,021,750
2121	BUILDINGS	1,293,757,000	344,224,000	288,507,811	55,716,189
2122	FURNITURE	3,246,000	2,368,000	1,275,678	1,092,322
2123.1	OFFICE SUPPORT EQPT	22,021,000	12,354,000	9,997,534	2,356,466
2123.2	COMPANY COMM EQPT	226,778,000	141,500,000	113,615,778	27,884,222
2124	GENL PURP COMPUTERS	318,628,000	170,087,000	155,490,464	14,596,536
2211	ANALOG ELECT SW	1,479,641,000	943,673,000	1,013,554,085	-69,881,085
2212	DIGITAL ELECT SW	1,873,865,000	555,250,000	781,401,705	-226,151,705
2220	OPERATOR SYSTEMS	106,075,000	62,012,000	39,353,825	22,658,175
2231	RADIO	41,338,000	26,306,000	24,058,716	2,247,284
2232	CIRCUIT EQPT				
	DIGITAL DATA SYSTEMS	70,475,000	37,351,000	36,999,375	351,625
	DIGITAL CIRCUIT	2,772,205,000	1,261,317,000	1,494,218,495	-232,901,495
	ANALOG CIRCUIT	472,426,000	363,972,000	337,312,164	26,659,836
2311	STATION APPARATUS	2,859,000	1,584,000	952,047	631,953
2341	LARGE PBX	28,523,000	16,115,000	11,808,522	4,306,478
2351	PUBLIC TELEPHONE	123,076,000	86,276,000	81,107,084	5,168,916
2362	OTHER TERMINAL EQPT	131,997,000	80,496,000	63,886,548	16,609,452
2411	POLES	195,227,000	167,418,000	245,205,112	-77,787,112
2421	AERIAL CABLE	1,067,898,000	700,013,000	768,886,560	-68,873,560
2422	UNDERGROUND CABLE				
	#REF!	1,226,140,000	674,979,000	897,534,480	-222,555,480
	TOLL METALLIC	11,694,000	10,527,000	9,273,342	1,253,658
	#REF!	273,127,000	57,666,000	78,114,322	-20,448,322
	TOLL FIBER	36,045,000	16,290,000	15,859,800	430,200
2423	BURIED CABLE				
	#REF!	3,378,160,000	1,910,035,000	2,087,702,880	-177,667,880
	TOLL METALLIC	74,197,000	49,113,000	58,096,251	-8,983,251
	#REF!	123,596,000	19,820,000	23,854,028	-4,034,028
	TOLL FIBER	130,255,000	33,937,000	37,773,950	-3,836,950
2424	SUBMARINE CABLE	2,220,000	1,337,000	1,132,200	204,800
2426	INTRABLDG NTWK CABLE	96,759,000	67,821,000	54,765,594	13,055,406
2431	AERIAL WIRE	224,000	2,303,000	317,632	1,985,368
2441	CONDUIT SYSTEMS	1,058,090,000	264,696,000	319,543,180	-54,847,180
	TOTAL	16,919,266,000	8,225,323,000	9,182,306,428	-956,983,428

PRICE CAP STRUCTURE



***Common line public policy element would be phased out commensurate with SLC increases**

Appendix 3

Appendix 4

FORBEARANCE

In the NPRM, the Commission asked whether high-capacity special access services should be removed from price cap regulation.[1] In addition, the Commission proposed to remove services from tariff regulation in areas where substantial competition is present.[2] Special access service not only should be removed from price cap regulation but also should be forborne from tariff regulation as well. In addition, the Commission should forbear from tariff regulation on dedicated transport to end offices and tandem offices, as well as on directory assistance, operator services and interexchange services.[3]

The 1996 Act provides for regulatory flexibility by requiring the Commission to forbear from applying any regulation or any provision of the Communications Act, to telecommunications carriers or telecommunications services, or classes thereof, if the Commission determines that, in any or some of its or their geographic markets:

> (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable, and are not unjustly or unreasonably discriminatory;
>
> (2) enforcement of such regulation or provision is not necessary for the protection of consumers; and
>
> (3) forbearance from applying such provision or regulation is consistent with the public interest.[4]

The first statutory requirement is that the Commission make a determination whether carriers could charge rates, or impose terms and conditions that violate Section 201 or 202 of the Communications Act.[5] The Commission has concluded that the availability of close substitutes fostered market forces that will generally ensure that the rates, practices, and classifications of interexchange carriers are just and reasonable and not unjustly or unreasonably discriminatory.[6]

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[1] NPRM at 153

[2] NPRM at 149

[3] Carriers should be allowed to continue to file tariffs for interexchange services as advocated in SBC Communications Inc. Comments filed January 28, 1997, with respect to AT&T's Petition for Reconsideration in CC Docket No. 96-61.

[4] 10(a), 47 U.S.C. 160(a)

[5] AT&T Reclassification Order, 11 FCC Rcd at 3305-07

[6] Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket 96-61 page 14, adopted October 29, 1996

Unlike switched services, high capacity special access services are generally concentrated in revenue rich urban markets. There have been direct substitutes for special access services in the marketplace for years, putting special access markets at the forefront of local telecommunications competition. Because displacement of special access requires no interconnection with LEC services or LEC switches, IXCs and competitive access providers ("CAPs") are able to displace LEC facilities without the use of any LEC resources.[7]

A quick analysis of data for major markets supports the conclusion that direct substitutes for special access services exist and are being used by LEC customers. For example, a 1995 study commissioned by SBC Communications Inc. ("SBC") demonstrated that in the Dallas market, SWBT had already lost approximately 41.2% of the high capacity special access market as of the fourth quarter 1994.[8] Similar losses of 31.6% were shown in the Houston market during this time period, figures very similar to the market share losses experienced by AT&T in today's interexchange markets. SWBT, of course, is not unique in this regard. Similar market losses are occurring in most major markets, such as New York, Chicago, and Los Angeles.

It is important to note that these large market share losses were incurred without the availability of unbundled elements and with only limited use of collocation. The 1996 Act virtually guarantees ubiquitous availability of product and services substitutable with these access services through the recombination of LEC unbundled elements. In addition, the 1996 Act requires collocation of competitor equipment on LEC premises, making it very easy for a competitive access provider or interexchange carrier to combine its facilities with LEC unbundled elements to directly compete with LEC special access and direct trunked transport services.[9] Forbearance should be granted for special access services in all areas and for direct trunked transport in end offices and tandem offices.

With regard to interexchange services, the Commission found in the AT&T domestic Order that the domestic interstate interexchange market was competitive enough to reclassify AT&T as nondominant while it retained a 58% share of the market.[10] In contrast, SWBT has a de minimis market share in the interexchange marketplace. Therefore, SWBT should be declared nondominant for interexchange services and tariff regulation should be forborne.

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[7] *See,* SBC's Comments in response to the Second FNPRM in CC Docket No. 94-1, which demonstrate the extensive presence of alternate providers operating in SWBT's serving areas.

[8] Quality Strategies study, ©1995

[9] Section 251(c)(6)

[10] AT&T Domestic Order

Directory assistance and other operator services are also intensely competitive. Competitors like Excell Agent Services, INFONXX, Metro One Communications[11], GTE, CFW and other have captured much of this market. For example, in the past year, AT&T has announced that it is taking back all of its directory assistance traffic from SWBT. Competitors are now able to gain entry into the directory assistance market easily and quickly capture market share. In January, 1995, Excell Agent Services handled its first directory assistance call for one IXC. Today, it is reported that Excell "has over 200 operators handling directory assistance traffic for several telecommunications providers, including three of the six largest long distance firms."[12] This rapid expansion in the directory assistance market, along with the ubiquitous availability of operators services and directory assistance unbundled elements, provides ample justification to forbear these services from tariff regulation.[13]

With respect to the second statutory requirement for forbearance, the Commission has determined that competitive forces protected consumers and that tariff regulation was unnecessary to protect consumer interests.[14] The Commission concluded that market forces, administration of Section 208 complaint process and the Commission's ability to reimpose tariff regulation was sufficient to protect consumers.[15] Tariff regulation is no longer needed to protect consumers with respect to special access services, direct trunked transport, operator services, directory assistance and interexchange services. In fact, since customers for special access, direct trunked transport, operator service and directory assistance are generally sophisticated interexchange carriers and large businesses, the need for tariff regulation is even more minuscule. Further, since so called "nondominant" competitive providers offer these services under streamlined regulation utilizing almost exclusively contract pricing, the majority of carriers offering these services are virtually free from any regulation. In addition, since virtually all large business customers have a direct relationship with their selected interexchange carrier, demand elasticity is increased and the threshold to influence a customer to switch access carriers is quite small. Thus, tariff regulation for special access, direct trunked transport, directory assistance, operator services and interexchange services is unnecessary.

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[11]Metro One's clients include Ameritech Cellular services, AT&T wireless Services Inc., Bell Atlantic NYNEX Mobile, BellSouth Cellular, GTE Mobilnet Inc and others.

[12] Business Wire, August 12, 1996

[13]Under the Telecommunications Act of 1996, SWBT and other ILECs are required to provide operator services and directory assistance to LSPs by privately negotiated contracts. Since the Commission rules (51.217(a)(b)) make no distinction among competing providers of local, intrastate or interstate services, SWBT will provide access to all operator services, directory assistance, and associated call-related databases to all carriers pursuant to the privately negotiated contracts required by the 1996 Act. See Letter from Todd Silbergeld, Director Federal Regulatory, SBC, to William F. Caton, Acting Secretary, FCC, September 23, 1996, filed in CC Docket No. 96-98.

[14]Docket 96-61 Order, pars. 29 and 36-37

[15]Docket 96-61 Order, par. 36

The third statutory requirement requires the Commission to determine whether forbearance from tariff regulation is consistent with the public interest. In making this determination, the statute specifically requires the Commission to consider whether forbearance will promote competitive market conditions, including the extent to which forbearance will enhance competition among providers of telecommunications services.[16] The Commission has found that the elimination of tariff regulation[17] would enhance competition among providers of such services, promote competitive market conditions, and achieve other objectives that are in the public interest, including the elimination of the possible invocation of the filed rate doctrine and establishing market conditions that more closely resemble an unregulated environment.[18] The elimination of tariff regulation for LEC special access service, direct trunked transport, directory assistance, operator services and interexchange services would benefit consumers.

Since interconnection and collocation agreements are approved by state commission and applied on a state-wide basis, the relevant geography over which the Commission should apply the three part statutory requirements on special access services is on a state-by-state basis. Since operator service and directory assistance are geographically nonspecific services, the Commission should be forebear tariff regulation on a region-wide basis. Similarly, since LECs have a de minimis market share in interexchange services, interexchange service should be forborne on a region-wide basis.

In view of the widespread nature of competitive alternatives and the years of Commission efforts to advance transport competition, the Commission should not wait for companies to file individual petitions for forbearance for special access services and direct trunked transport. In the interest of conserving the Commission's finite resources and in order to accelerate consumer benefits of increased special access competition, the Commission should rely on the record of the Access Reform proceeding to remove special access services, direct trunked transport, directory assistance, operator services, and interexchange services from regulation so that individual company showings would not be required to remove these services from tariff regulation.

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[16]47 U.S.C. at 160(a) and 160(b)

[17]In SWBT's opinion, there is a clear distinction between pervasive tariff regulation and the permissive detariffing approach suggested in the Comments of SBC previously referenced herein.

[18]Docket 96-61 Order, par. 52

Appendix 5

Productivity Offset (X-Factor) Analysis

The TFP approach is the proper foundation.

Consistent with SWBT's approach since 1987, SWBT again strongly asserts that the measurement of historical LEC productivity utilized for decisions made on the LEC price cap plan should be on a total factor productivity (TFP) basis. There is a compelling record in support of the TFP approach. The Commission, in its Fourth FNPRM in the Price Cap Review, CC Docket No. 94-1, concluded that a TFP-based approach was the proper principles-based approach to measuring historical productivity.

A five-year moving average of historical total factor productivity (TFP) results, as prepared by Christensen Associates and filed by USTA on this date,[1] is the proper starting point for setting the forward-looking X-Factor. The LEC TFP differential for the most recent five years 1991-95 is 2.7%. As described below, reductions from that estimate are appropriate.

The current 5.3% X-Factor associated with the no sharing option is totally inappropriate. SWBT and other price cap LECs, by previously choosing the 5.3% X-Factor / no sharing option, did so to obtain the proper form of incentive regulation (i.e., out from under earnings sharing) and to avoid the restrictive cost-plus ROR regulation alternative represented by the 4.0% / very tight sharing option. SWBT's choice among alternatives was not in any way a validation of the Commission's 5.3% estimate. Also, the Commission made the X-Factor / sharing elections effective for only a one-year planning horizon.

The 5.3% X-Factor cannot be sustained into the future. This was true even before the rapid acceleration of competition resulting from the implementation of 1996 Act is considered.

The potential for widespread competition occurs for SWBT and other ILECs for the entire state when interconnection with the ILEC is available in that state. This will happen almost immediately (certainly in 1997) for SWBT and other price cap LECs. Due to the immediacy of interconnection, there is no need to distinguish between Phase 1 of Access Reform and the future

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[1]See "Updated Results for the Simplified TFPRP Model and Response to Productivity Questions in FCC's Access reform Proceeding," Christensen Associates, attachment to USTA Comments, filed on this date in this docket. The TFP Review Plan model utilized by Christensen Associates presents the TFP data and calculations in a framework that is similar to the Tariff Review Plan submissions already utilized by the Commission staff. The TFP Review Plan model uses publicly-available data, is verifiable and relatively simple. All calculations are fully sourced, documented and have been supported.

of the baseline price cap plan rules when considering which rules should apply.

Reductions to the historical TFP results are appropriate.

SWBT's plan for access reform recommends that key interstate rate elements (i.e., the CCL charge and the TIC) be restructured, shifting rate recovery amounts from per minute charges to public policy rate elements. The rate restructuring recommended by SWBT will reduce the productivity potential of the price cap LECs by shifting revenue sources from more rapidly growing demand units (minutes of use) to more slowly increasing, or declining demand units (e.g., presubscribed lines, public policy rate elements, and/or the new federal Universal Service Fund). This explicitly reduces the ability of the LECs to meet a specific productivity offset hurdle. The drain on achieved ILEC productivity caused by this rate restructuring (or whatever rate structure changes ordered by the Commission) should be recognized as a reduction to the X-Factor.

Amounts previously recovered by CCL charge and priced on a per-MOU basis, will now grow by lines, or slower. The relevant CCL revenue[2] is approximately 14% of total interstate price cap revenue. CCL MOU growth has exceeded lines growth by about 4% to 5% per year during the past five or six years. Based on the fact that the CCL price cap index formula reduces CCL prices by a "g/2" factor, essentially giving back half of the MOU growth above lines growth, the CCL restructure is worth about 0.3% per year in total price cap revenue growth (4% x 1/2 x 14%). When not netting out the "g/2" effect on price cap indexes, the effect on interstate revenue growth of the CCL restructure is a reduction of approximately 0.5% per year.

Costs that were previously recovered by the TIC, on a traffic-sensitive MOU basis, will be recovered by an element that will experience much slower demand growth. Traffic-sensitive MOU growth has been about 6.5% per year. TIC revenue currently represents about 12.6% of price cap revenue. If a flat-rated TIC rate structure[3] results in essentially zero demand growth, the TIC restructure is worth about 0.8% per year in total price cap revenue growth. (6.5% x 12.6%)

The NPRM considers and SWBT recommends additional rate restructuring. While these additional rate restructures should be permissive rather than prescriptive, many will also reduce measured productivity and revenue growth. While SWBT has not provided any specific quantifications of the productivity effects of these other restructurings, the unambiguous effect of

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[2]This revenue excludes payphone costs that are now nonregulated and includes the Long Term Support (LTS) amounts to be shifted to Universal Service Fund recovery.

[3]See Section II of SWBT's Comments for a more detailed description of SWBT's proposal for the TIC rate restructuring.

changes that move rate recovery off of MOU-based demand (or other demand units that have historically grown more rapidly) will be to reduce measured ILEC productivity growth and interstate revenue growth.

Under any scenario where actual competition must be demonstrated before ILECs are able to have markets removed from price cap regulation, the drain on productivity from market losses will reduce achieved productivity before the price cap constraints are removed. As a result, competitive losses will reduce ILEC revenue growth and measured productivity while these services are being price regulated under price cap regulation. Thus, the effects on TFP of competitive losses must be reflected in the X-Factor while services are subject to price cap regulation.

As an example of the significance of this effect, a 10% loss in output growth over 5 five years reduces revenue by an average of 2% per year. This reduces TFP by between 0.6% and 1.0% per year. If the output loss was approximately 20% over 5 years, the reduction in TFP would be between 1.2% and 2.0% per year.[4] These results are based on empirical studies and the fact that telecommunications firms (and other firms for that matter) cannot shed fixed costs and costs dedicated to specific tasks as rapidly as they may lose revenues to competition.

The adjustments to the X-Factor described above are presented in the following table:

[4]None of the above is to imply that SWBT supports any use of specific market share losses as triggers for regulatory relief, which it does not.

Determination of X-Factor
Including Forward-Looking Adjustments

		X-Factor Based on TFP	X-Factor Based on Revenue
Forward-Looking Adjustments to X-Factor:			
Effects of Restructuring:	CCL and TIC	-0.4%	-1.4%
	Other Restruct.	not quantified	not quantified
Effects of Lost Output Growth		-0.6% to -2.0%	-2.0% to -4.0%
Effects of Lower Margins for Remaining Access Demand		not quantified	not quantified
Range of Minimum Reductions Omitting Factors Not Quantified		-1.0% to -2.4%	-3.4% to-5.4%
Historical Results as Basis for X-Factor		2.7%[5]	4.0%[6]
Approximate X-Factor Reflecting Forward-Looking Factors (considering both methods and effects not quantified)			**0%**

[5]Christensen Associates, LEC TFP differential for 1991-95 (most recent five-year period)

[6]The Commission's original methods, using an interstate revenue requirements method, when revised to exclude the 1984/85 data point, yielded a 4.0% estimate.

The profound changes that have occurred and that will rapidly occur in telecommunications markets dictate that the Commission relax its regulation of the incumbent price cap LECs, including the restraint represented by the X-Factor.[7]

A fixed X-Factor, rather than requiring annual updates of TFP results may be appropriate. A fixed X-Factor is simpler than an annual update approach, though the TFP calculations themselves are relatively simple and verifiable. Use of a fixed factor would be consistent with the past Commission decisions on X-Factors applicable to AT&T, the LECs and cable TV companies. It would avoid the recurrent debate associated with prior reviews, reducing the ability the LECs' competitors to game the debate.

Also, the five-year moving average of history may be slow to respond to changing lower productivity trends that is expected as a result of competition and that should be reflected in forward-looking regulation.

By supporting a fixed X-Factor, as opposed to a moving average of historical results, SWBT is not recommending that the Commission ignore the strong record already developed by USTA supporting TFP. A fixed factor can and should be grounded in the historical TFP results. The TFP method is the fundamentally sound economic answer.

However, basing the X-Factor that will apply in the future on historical results is inconsistent with post-Act environment. Old results and regulation applied to "X" would conflict with new regulation of access prices. The regulatory paradigm has shifted so profoundly as a result of the 1996 Act, that SWBT can no longer support use of an average of historical TFP results alone as appropriate for the current and future environment.

SWBT continues to oppose the inclusion of an input inflation differential (IID)[8] in the historical productivity measurement on both conceptual and practical grounds. The inclusion of an IID adds arbitrary and harmful volatility to the productivity measurement. Moreover, the long-term trend of the IID, when TFP measurement is properly and consistently performed, is zero.[9]

A Consumer Productivity Dividend (CPD) should not be included in the X-Factor. The

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[7]For a description, see SWBT Comments.

[8]The IID is the extent to which the input inflation experienced by the price cap LECs is less than the input inflation experienced by all firms in nonfarm private business sector of the U.S. economy.

[9]The IID for 1991-95 is -0.6%. As a result, including the IID in the historical productivity measurement would reduce the LEC productivity differential of 2.7% to 2.1%.

purpose of the CPD was to provide access customers with the first financial benefits of the conversion from ROR regulation to price cap regulation. That conversion is now six years old and has run its course. The CPD has already provided a total consumer benefit of approximately $2.1 billion to IXCs and other interstate access customers. Setting the new-year CPD amount back to zero would still preserve an annual consumer benefit of approximately $600 million per year for each year into the future.[10]

Recommendation

The Commission should adopt a relatively looser regulatory constraint (less binding X-Factor) on those services where competitive market pressures substitute for regulation. A zero X-Factor on the Network Service Basket is appropriate. This is consistent with applying less regulation when competition is available to provide pricing discipline.

The Commission should adopt a fixed X-Factor for the Public Policy Basket grounded in the most recent Christensen TFP differential results. The most recent results are a 2.7% differential. Reductions to that level should be made for the effects of rate restructuring that reduces interstate revenue growth and TFP growth.

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[10]Setting CPD to zero going forward would only stop the annual growth in that benefit to IXCs of an additional amount each year equal to an added 0.5% CPD per year times the total price cap LEC revenues subject to the X-Factor.

CERTIFICATE OF SERVICE

I, Liz Jensen, hereby certify that the foregoing, Comments of Southwestern Bell Telephone Company, in Docket No. 96-262, have been served this 29th day of January, 1997 to the Parties of Record.

Liz Jensen

Liz Jensen

January 29, 1997

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